H.R. 3248; THE FAIR TRADE IN FINANCIAL SERVICES ACT OF 1993

HEARING

BEFORE THE

SUBCOMMITTEE ON FINANCIAL INSTITUTIONS SUPERVISION, REGULATION AND DEPOSIT INSURANCE

OF THE

COMMITTEE ON BANKING, FINANCE AND URBAN AFFAIRS HOUSE OF REPRESENTATIVES

ONE HUNDRED THIRD CONGRESS

SECOND SESSION

FEBRUARY 1, 1994

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TUESDAY, FEBRUARY 1, 1994

APPENDIX

H.R. 3248, THE FAIR TRADE IN FINANCIAL SERVICES ACT OF 1993

TUESDAY, FEBRUARY 1, 1994

HOUSE OF REPRESENTATIVES,
SUBCOMMITTEE ON FINANCIAL INSTITUTIONS
SUPERVISION, REGULATION AND DEPOSIT INSURANCE,
COMMITTEE ON BANKING, FINANCE AND URBAN AFFAIRS,
Washington, DC.

The subcommittee met, pursuant to notice, at 9:40 a.m., in room 2128, Rayburn House Office Building, Hon. Stephen L. Neal [chairman of the subcommittee] presiding.

Present: Chairman Neal, Representatives Schumer, Frank, Klein, Leach, Nussle, Linder, and Huffington.

Chairman NEAL. We will call the subcommittee to order at this time.

This morning the subcommittee meets to hear testimony on H.R. 3248, the Fair Trade in Financial Services Act. This legislation was developed by the Subcommittee on International Development and reported prior to the conclusion of the recent Uruguay round of GATT negotiations. It was intended to help induce other countries to reach an agreement on financial services, as part of the GATT, under which all countries would offer "national treatment" to foreign banks and other financial firms operating on their territory. That effort, so far, has failed.

National treatment means that the host country treats foreign banks the same as its own banks. It offers them the same rights and privileges and subjects them to the same rules and regulations, without discrimination. It also means, as defined in this legislation, that foreign financial firms enjoy fair access to their markets.

The United States has traditionally adopted something close to national treatment as its basic norm. National treatment has been the objective of our GATT negotiators on financial services. This legislation, however, explicitly authorizes discrimination against banks and securities firms from countries that deny national treatment to U.S. banks. The administration supports it in the hope that the threat of retaliatory discrimination will finally persuade other countries to open their financial markets to U.S. firms and treat them fairly.

Most other industrial countries do offer national treatment to U.S. banks. The major exceptions are Japan, and a few so-called emerging market countries. They apparently refused, in the recent GATT negotiations, to commit themselves to a full opening of their financial markets.

That is not, however, the end of the story. The Uruguay round was officially left open on financial services, with ample time to complete a satisfactory agreement and incorporate it into the GATT. If we succeed in obtaining satisfactory national treatment in the upcoming, and presumably final, phase of negotiations on financial services, the sanction authorized in this legislation will not come into play. If not, we will be in a position to depart from our historical practice and discriminate against any foreign country that denies national treatment to U.S. banks.

I would like for today's hearing to focus on a few issues:

One, the status of the GATT negotiations, including the major countries that are resisting the adoption of national treatment and their importance for U.S. financial firms.

Two, the role of the Secretary of the Treasury in determining the possible imposition of sanctions.

Three, the question of cross retaliation, that is the imposition of sanctions against foreign banks if the foreign country discriminates against U.S. securities firms or vice versa.

Four, the timing of the sanctions; that is, would it not be advisable to postpone their possible implementation until such time as the final phase of GATT negotiations on financial services were to definitely fail, if that be the case.

This approach would make it clear that the purpose of this legislation is to help reach a satisfactory financial services agreement and that discriminatory retaliation is a last resort.

And, finally, five, the general objection raised by the Federal Reserve against this type of legislation. As I understand that objection, it might be phrased something like this: We benefit considerably from the economic contributions foreign banks make in our markets and we would simply be denying ourselves those benefits if we discriminated against those banks.

Our witnesses today are the Honorable Lawrence Summers, Under Secretary for International Affairs at Treasury; the Honorable Rufus Yerxa, Deputy U.S. Trade Representative; and the Honorable John LaWare, Governor of the Federal Reserve System.

Gentlemen, thank you very much for being with us this morning, and we will put your entire statements in the record; and before, excuse me, recognizing you, I would like to recognize our very distinguished ranking minority member, Mr. Leach.

Mr. LEACH. Well, thank you, Mr. Chairman.

I just want to say on behalf of the minority, we do welcome the bill; it comes against the backdrop of an unfortunate and catastrophic event. The unfortunate event is that the GATT round does not include anything particularly forthcoming on financial services.

The catastrophic event is, of course, the announcement of the distinguished subcommittee Chair that he will not seek reelection; and we are all unhappy to hear that, Stephen, and wish you well in whatever you might do.

Chairman NEAL. Thank you.

Mr. LEACH. Given the GATT circumstance, this legislation becomes more, not less, important. There are a host of countries that have financial services strictures even more difficult than Japan. For example, Brazil, India, Taiwan, all have restrictions in place.

And, frankly, it is the minority's strong opinion that big fences don't make good neighbors and that we should make it very clear that reciprocity is a reasonable goal of American foreign economic policy.

Thank you, Mr. Chairman.

Chairman NEAL. Thank you.

Mr. LEACH. And, Mr. Chairman, I would like unanimous consent to put a statement in the record.

Chairman NEAL. Yes, sir, without objection. And thank you for your being here this morning.

[The prepared statement of Mr. James A. Leach can be found in the appendix.]

Chairman NEAL. We will put, without objection, the entire statements of all of our witnesses in the record and ask that you summarize.

And if there is no objection, we will just recognize you in the order in which we mentioned your names. So first we will then hear from Mr. Summers.

STATEMENT OF LAWRENCE H. SUMMERS, UNDER SECRETARY FOR INTERNATIONAL AFFAIRS, DEPARTMENT OF THE TREASURY

Mr. SUMMERS. Thank you, very much, Mr. Chairman. I am pleased to have this opportunity to testify in support of Fair Trade in Financial Services.

As Secretary Bentsen and Ambassador Kantor stated in their recent joint letter, the administration is united in the belief that prompt passage is essential to our strategy of opening foreign financial markets in a multilateral context for U.S. financial institutions.

The recent conclusion of the Uruguay round of negotiations, as well as bilateral discussions on financial services with a number of countries, particularly Japan, reaffirm our belief in the importance of this legislation. The agreement reached in Geneva will permit us to continue to negotiate and improve commitments until 6 months after the Uruguay round enters into force. We are currently committed to preserving the existing operations and activities of foreign financial firms. However, we are not committed to granting new powers, expanded operations in new areas, or new entries.

At the end of the 6-month period following entry into force of the Uruguay round, the United States will be free to submit any MFN exemptions that we wish and to modify and finalize our market access and our national treatment obligations.

This outcome from the Uruguay round, this somewhat difficult circumstance, has important virtues.

First, it allows us to harvest any commitments into legally binding commitments in the General Agreements on Trade and Services; second, it preserves our negotiating leverage; third, it holds open the prospect of a broad multilateral framework for future liberalization in this area. We intend to use the existing window of time—up to and including 6 months after the Uruguay round goes into force—to negotiate intensively for further liberalization.

To be absolutely clear, our goal is to open foreign markets, not to close our own. We will approach these negotiations in a reason-

able and pragmatic manner. To that end, we have adopted some basic guidelines for our approach.

First, we are looking for agreements which provide access to foreign markets and provide national treatment; second, we will take a constructive approach, which, as we negotiate, keeps our markets open by grandfathering the existing operations of firms already established; third, our objective remains an agreement on a multilateral basis. However, we cannot accept the situation in which other nations retain the right to discriminate against our firms while their firms are permitted to expand in our market.

The stakes here are high. Financial services now account for 6 percent of GNP. They contribute several billion dollars of trade surplus to offset our trade deficit on merchandise trade. United States financial institutions need to be successful abroad if they are to have room to spread out the costs of innovating and to remain competitive at home. Already, for example, roughly 10 percent of the total assets of U.S. banks are accounted for by their foreign affiliates.

More broadly, open foreign financial markets serve the administration's goal of strengthening our economy because they improve the access to capital for American firms wishing to export into foreign markets.

As President Clinton urged a year ago, we must compete not retreat. And the Fair Trade in Financial Services will help us.

Secretary Bentsen underscored the importance of the financial services sector in his recent speech in Bangkok when he said "the financial services sector is a little bit like the nervous system. It sends signals to the industrial muscle of an economy as to where those resources ought to go, where they will have the most effective growth and the highest return." Efficient and open financial services markets are in our interests, and they are in the domestic interest of the economies with whom we are negotiating.

Our approach to Fair Trade in Financial Services legislation specifically reflects several principles. First, the Secretary of Treasury, in full consultation with the U.S. Trade Representative and the Secretary of State and other relevant government agencies, should exercise authority to impose sanctions in accordance with the specific direction of the President, if any.

Second, the legislation must be exercised in a manner consistent with and supportive of whatever commitments we ultimately make in the GATS.

Third, it is crucial that existing operations of foreign financial institutions already established in the United States should be protected. The impact of this legislation should be prospective, to minimize potential disruption to our market, and reduce the risks of possible retaliation.

Fourth, regulatory authorities must be assured appropriate scope to exercise their statutory responsibilities to safeguard the safety and soundness of the financial system and to protect investors.

And, finally, it is crucial, especially in this sensitive area, that the bill provide ample discretion for negotiators rather than automatic triggers tied to rigid deadlines.

We believe that H.R. 3248 goes a long way toward providing a more effective means to achieving our goal of obtaining substantial

market access and national treatment for U.S. firms in foreign markets that other countries' firms enjoy in our open market. Our negotiating efforts, with the end of the Uruguay round, are beginning a new phase; so it is especially important that we implement this type of legislation now.

We look forward to working with the subcommittee and others in Congress to iron out any outstanding issues so that the legislation can reach the President for signature soon.

And let me just conclude by thanking you, Congressman Leach, and Congressman Schumer, for your very important leadership in this area.

[The prepared statement of Mr. Summers can be found in the appendix.]

Chairman NEAL. Thank you, sir, very much.

Mr. Yerxa.

STATEMENT OF RUFUS H. YERXA, DEPUTY U.S. TRADE REPRESENTATIVE

Mr. YERXA. Thank you, Mr. Chairman. And thank you for the opportunity to appear before your subcommittee and comment on this very important legislation.

I would like to share in the remarks of Secretary Summers in paying tribute to the subcommittee for the hard work that has been done on this important matter.

I think I want to start at the outset by clearing up any possible lingering doubt about the unified view of the administration, both the Trade Representative and the Treasury Department, on the importance of obtaining greater mechanisms to deal with the problem of unfair trade and financial services.

The Office of the U.S. Trade Representative is committed to expanding market access for and improving treatment of our very competitive banking and securities firms in foreign countries because of the close relationship that exists between trade, investment, and finance.

Because the aim of this legislation is that aim, we support the legislation in its basic thrust. The administration has stated that our trade policy must be part of a coordinated and integrated economic strategy, and that policy must be oriented toward expanding trade through market-opening measures.

Now, there are those who want to see us close certain markets and even to use the unfairness of other countries as a pretext or an excuse for closing our own markets, and that will never be the policy of this administration.

Some might suggest there is some hidden purpose behind this legislation to allow the United States to become more closed to foreign competition, but I am convinced that that is not what our financial services providers want; it is not what you, the sponsors of the legislation, want to see; and it is certainly not what the administration wants to see.

But the simple fact is that unless you are prepared to be resolute and forceful with your trading partners in obtaining conditions of basic fairness, they just will not come about naturally.

This act complements our success in financial services in prior negotiating efforts, including the North American Free Trade

Agreement, and will supplement our efforts in the Uruguay round of multilateral negotiations, and the Japan framework. We intend to do all we can to ensure that U.S. banks and securities firms can continue to be innovative and competitive worldwide.

Let me comment first, briefly, on the Uruguay round, Mr. Chairman. We did achieve an excellent overall result in the agreement on services. However, the results in terms of market access commitments in very important sectors, most notably the financial services sector, were disappointing. We agreed on a framework for trade and financial services but did not obtain the full commitments on market access that we sought from a critical mass of countries. And, though we have gained additional time to negotiate with our trading partners, we have to see what mechanisms will best enable us to obtain the appropriate conditions of access from those partners.

The agreement provides for continuing negotiation within the GATT context, which will take place over the coming months. But in the event we are not able to achieve sufficient progress in these negotiations, this legislation will help to ensure that we have incentives to encourage other countries to liberalize in the future.

Commenting briefly on Japan, we are nearing the deadline set last July when President Clinton and then-Prime Minister Miyazawa signed a framework for consultations that calls for agreement on market-opening measures in several areas, including financial services. Negotiations are now actively under way.

The Japanese financial services markets are, in most cases, the second largest, and in some cases, the largest in the world. Effective access to these markets is very important for the ability of U.S. financial services firms to expand and remain competitive worldwide.

Also, increasing United States financial services firms access to Japan will help expand market access for other United States services and manufacturing companies. And for this reason, we place great importance on the framework consultations.

The Fair Trade in Financial Services Act supports our efforts under this framework. As the second largest economy in the world, Japan must be aware that if it is not willing to provide greater openness and transparency for United States firms, Japanese companies should not expect to count on the full and open access in the United States markets.

We support the legislation's intent to address market access problems in the highly regulated sectors of banking and securities. An effective policy instrument to achieve our goals should: First, provide for the authority to act within the executive branch; second, establish a well-coordinated interagency consultation process; and, third, protect the interests of U.S. firms abroad; fourth, support international legal principles; fifth, utilize relevant dispute settlement mechanisms in the GATT successor organization, the World Trade Organization; and, sixth, respect the authority of independent regulators.

Let me just elaborate on two or three of these points. With respect to executive authority in consultations, denying a firm's opportunity to expand in a new business in response to its home country's failure to provide for fair competition is a decision that

should be made by the executive branch. Specifically, we believe that this responsibility for banking and securities should be lodged with the Secretary of the Treasury in consultation with the Secretary of State and the Trade Representative and should be subject to the specific direction, if any, of the President.

The process must allow for the exercise of discretion rather than mandating action. This will ensure that the executive can maximize the use of this new authority, in conjunction with other policy instruments, and guarantees that an appropriate range of interests are taken into account.

With respect to protecting U.S. firms abroad, we should be mindful of the affect this legislation would have on U.S. financial services firms established abroad.

When the European Community passed the Second Banking Directive the United States was assured that the directive would not negatively affect U.S. banks already doing business in the EC that are subject to the directive. The United States does not intend to target, under this legislation, existing operations of foreign companies established within the United States. We believe that any policy should be focused on limiting access to new firms or new opportunities.

And, last, with respect to international legal principles and relevant WTO dispute settlements, we have spent a great deal of time, Mr. Chairman, establishing an international investment regime grounded in some sound legal principles. And although that regime is not yet fully complete, we believe that these principles are important, and any mechanism we are establishing domestically should respect them.

We want to encourage countries to take advantage of the opportunities presented by continuing negotiations under the GATS framework in the financial services sector. And any country that guarantees national treatment and substantial full market access in its GATS complement, should be confident it will not be disadvantaged under this legislation. In other words, the legislation should encourage such participation rather than discourage it.

Now, I am not one of those who has given up hope that we can obtain very real and meaningful commitments in the future. I think the more countries begin to see that it is in their self-interest to move in the financial services realm in the same direction they are moving in the trade and goods realm, the more we will be able to achieve real meaningful expansion of the GATS commitments by other countries.

In conclusion, the administration does intend to use every opportunity available, bilaterally or multilaterally, to assure U.S. banks and securities firms can continue to be innovative and competitive worldwide.

At the same time, however, we expect that other countries will provide us the same degree of openness and fairness and that it is important to point out to them that the open market of the United States is not a free market; it is one in which fairness is required.

The aim of this legislation is to provide an effective response, or should I say an incentive, if our trading partners fail to guarantee proper conditions of fairness.

We look forward to working with you and the subcommittee members in fashioning an appropriate bill that can be quickly enacted into law and signed by the President.

Thank you, Mr. Chairman.

[The prepared statement of Mr. Rufus H. Yerxa can be found in the appendix.]

Chairman NEAL. Thank you, sir, very much.

Governor LaWare.

STATEMENT OF JOHN P. LaWARE, GOVERNOR, BOARD OF GOVERNORS, FEDERAL RESERVE SYSTEM

Mr. LAWARE. Thank you, Mr. Chairman and members of the subcommittee. I appreciate the opportunity to present the views of the Federal Reserve Board on the proposed legislation on Fair Trade in Financial Services, H.R. 3248. Given our role, as the central bank, in ensuring a healthy and efficient environment for the provision of financial services, the Federal Reserve has a special interest in this legislation.

On a number of previous occasions, before other committees, I have presented the views of the Fed on various proposals for legislation on Fair Trade in Financial Services. I will, therefore, keep my testimony brief and confine myself to those key points we consider to be of critical importance.

As I have emphasized before, the Federal Reserve shares the objectives of the proposed legislation. These objectives are important, and their achievement is desirable.

United States financial firms deserve to have the same opportunities to conduct operations in foreign financial markets as domestic firms have in those markets. They do not now have those opportunities in all markets. According U.S. firms such treatment would benefit not only them but also the host foreign countries themselves and the world financial system in general.

However, while sharing these important objectives, the Federal Reserve continues to oppose this kind of legislation. We oppose it for essentially two reasons: First, the existing U.S. policy of national treatment has served our country well. The U.S. banking market, and the U.S. financial markets more generally, are the most efficient, the most innovative, and the most sophisticated in the world.

Consumers of financial services in the United States are provided with access to a deep, varied, competitive, and efficient banking market in which they can satisfy their financial needs on the best possible terms. Foreign banks, by their presence in the United States and with the resources they bring from their parents, make a significant contribution to our market and to our economic growth; they enhance the availability and reduce the cost of financial services to U.S. firms and individuals as well as to U.S. public sector entities.

For these reasons, we simply do not consider legislation like that proposed to be in our own self-interest. If we were to adopt such legislation, we must be prepared to forego the considerable benefits of foreign banks' participation in our market if U.S. banks are not allowed to compete fully and equitably abroad.

Second, I note that the multilateral negotiations on trade in financial services will continue over the next 2 years, as agreed in the just-concluded Uruguay round. We believe these negotiations offer the best hope for achieving further progress in the opening of foreign financial markets for U.S. financial firms; and we strongly support the Treasury in its efforts in those negotiations.

We believe that the upcoming negotiations are at a critical juncture. It is incumbent upon the United States to continue to provide leadership by example for the rest of the world in order to preserve the principle of free, rather than reciprocal, trade. The former must continue to be our ultimate goal. Therefore, we do not agree with those who assert that the proposed Fair Trade in Financial Services legislation is desirable or necessary in the context of those negotiations.

Indeed, it is our view, based upon experience, that market forces and the desire of foreign officials to enhance the functioning of domestic financial markets are often the most potent forces to induce financial market liberalization; the negotiations provide a valuable framework for guiding that liberalization.

That said, however, if other views prevail on the need for Fair Trade in Financial Services legislation, we would prefer the current proposal, H.R. 3248, over other proposals because it clarifies the possible sanctions, authority, and procedures in a number of important respects.

First, we believe that, as between financial and trade policy officials, it is more appropriate that the Secretary of the Treasury should have authority to make determinations regarding whether denial of national treatment to U.S. banking organizations by a foreign country has a significant adverse effect on such organizations, as well as recommendations regarding sanctions in appropriate cases. The Treasury Department is better positioned to make such determinations, in view of the information available to the Treasury regarding the needs of both providers and consumers of financial services.

Second, the requirement that the Secretary consult with other relevant officials, including appropriate banking regulatory officials, before making such determinations helps to ensure that broader perspectives are incorporated in the decisionmaking process.

Third, the proposed legislation recognizes, in the residual discretion granted to the banking agencies, that imposition of sanctions in some circumstances, even if otherwise warranted, might be inconsistent with other objectives, such as the safe and sound operation of the financial system or the least-cost resolution of a failed bank.

Fourth, the proposed legislation excepts from its procedures countries that have provided the United States a binding and substantially full market access and national treatment commitment in financial services. This language seems to make it clear that the legislation is intended to be an adjunct to the ongoing negotiations with countries that have not yet made such commitments and is not a rejection of the principles of free trade and national treatment.

Finally, we believe that it is appropriate and important that no provision is included for retaliation across financial services sectors. As a consequence, even if, for example, U.S. securities or mutual funds might be having problems in other countries, U.S. banks and banking markets should not be jeopardized.

The desirability of market liberalization as an objective in the financial sector, as in other sectors, is virtually universally accepted. The United States has the opportunity to continue to exercise leadership in this area. I sincerely hope we take that opportunity. If not, any Fair Trade in Financial Services legislation should include the important improvements noted above in the current proposal.

I would also like to echo the hope, recently expressed in a joint statement by the Bankers' Association for Foreign Trade, the Bankers Roundtable, and the American Bankers Association that the retaliatory mechanism of any Fair Trade in Financial Services Act will never have to be used.

Thank you, Mr. Chairman.

[The prepared statement of Mr. LaWare can be found in the appendix.]

Chairman NEAL. Thank you, Governor.

I think you—I think this legislation is going to be very popular; and I think you probably recognize that and suggest that you want to be careful if we have such legislation you don't approve of. But we should—well, in that light, do you see anything in this legislation that you—that is of concern to you?

Mr. LAWARE. It is more of the principle of stepping up and interfering with market forces. We have——

Chairman NEAL. No. I understand that objection. But I am saying just given——

Mr. LAWARE. Yes.

Chairman NEAL. That Japan, for example, has a record of discriminating against American products, and there is a strong record of their not doing anything about it unless pressure is exerted. And everyone around here sort of knows that. And I think this legislation will probably sail right through. And I understand that you think we are denying ourselves benefits by passing something like this.

But given the popularity of it, is there anything in this particular legislation, other than the basic principle, that bothers you?

Do you read it, for example, to allow cross-retaliation between securities and banks?

Mr. LAWARE. No. As I commented in my testimony, we would prefer, definitely prefer, strongly prefer not to have cross-segment retaliation.

Chairman NEAL. How about the way the bill reads? Does it appear to you that there is such a possibility?

Mr. LAWARE. No. I think that the language of H.R. 3248 is much improved.

Chairman NEAL. OK. Any other thoughts?

Mr. LAWARE. Only the comment that market forces do work; and in Japan, for example, the commercial banking situation is a very good example. That has evolved significantly over the last several years to allow United States banks and foreign banks in general

to operate in Japan on virtually an equal footing with the Japanese banks.

Chairman NEAL. You know, again, I generally agree with you that we ought to rely on markets forces. I have also had the experience personally, I must tell you, of noting how the Japanese have discriminated against a product that is manufactured in my part of the country over many, many years in just an outrageous way.

In fact, in this case, they would not allow the product to be advertised in the Japanese language. They limited its sales to 3 percent of the sales outlets. And they administratively priced it about twice the price of the comparable domestic products.

That went on for years, and they simply refused to do anything about it. They would say they would do something about it but then wouldn't.

They do the same thing with rice today, for example, with beef, and citrus fruits, and so on and so on. They are denying benefits to their own citizens in a way that most folks around here find unacceptable. And that is why I feel this legislation will probably have broad support.

Mr. LAWARE. One of the things, on the banking front, that I always remind my Japanese friends about is, to my knowledge, no Japanese bank has ever been purchased by an American bank and yet they have come in here rather freely and purchased or acquired United States banks.

Mr. SCHUMER. What do we do about it?

Chairman NEAL. Gentlemen, do you all want to comment on Governor LaWare's problem with this legislation?

Mr. Summers.

Mr. SUMMERS. Well, I think that frankly, Congressman, the kind of questions that you were asking point up the considerations that have led this administration to support legislation of this kind.

I think it is clear from what I have said, from what Mr. Yerxa has said, from the letter that Ambassador Kantor and Secretary Bentsen sent that we have no desire to close the American market. This is no pretext for seeking to close the American market. This is a tool of leverage.

And I think if we have learned anything in the last few years, it is that a turn-the-other-cheek approach to trade policy does not work, that we are more likely to get results if we are prepared to respond in the event that we do not get results.

I am confident that with this enhanced authority we will be in a position to negotiate more effectively, and negotiating more effectively will result in more openness worldwide rather than less.

Chairman NEAL. Just one final question for you all. Is there anything in this particular legislation, as written in H.R. 3248, that you would like to see changed?

Mr. SUMMERS. We have collaborated closely in the preparation of this bill and think it is a very good bill.

We do have some specific technical problems with the grandfathering provision as it is now written because we are afraid that, as it is now written, it will be more broad in its application than is intended. As well as affording protection to Europe, it may afford protection to some of the countries where we still have major

problems. And I think that is something that, perhaps, should be looked at further in the drafting of the legislation.

We have no problem with the intent that the drafter showed, but we would think it very unfortunate if, inadvertently, Japan, for example, was to be exempt from being made subject to sanctions if progress was not made; and that may be an inadvertent consequence of the way the grandfathering is now written in.

Chairman NEAL. Let us have your comments on that, if you would. I quite agree with you on the overall purpose of this; it is not to close our markets, it is to open others. Mr. Yerxa.

Mr. YERXA. I would share the remarks that Secretary Summers has just made.

In general, we think this is very good legislation. There are a couple of specific technical points we have been working with the subcommittee and the subcommittee staff on, some issues relating to the provisions on consultations, sanctions, and discretion which I alluded to in my testimony. I think Treasury and USTR are in accord on these issues and are working with the committees and believe that we can fashion a product that we can all reach consensus on.

Let me just comment briefly, though, on some of the observations made by the Federal Reserve because I think it is quite clear that we have chosen to have an open financial services market in the United States, not as a matter of international economic policy but because it is in our own best interests and we believe that our citizenry gains from that.

It is, as you have all stated—and as we have said in our testimony—it is not and should not be the purpose of this legislation to fundamentally alter that policy; to begin to interfere with market forces. I don't envision this legislation leading to that result or being used in that manner.

But, you know, Mr. Chairman, you referred to some of the problems we have had with Japan in other sectors; and past history has demonstrated that in order to secure appropriate fairness and balance in our trade relationship with Japan, we have had to be forceful and apply pressure.

And there is very good news in that respect. You mentioned some of the examples of rice, beef, and citrus. When we used section 301 against Japan, we opened up the beef and citrus markets which were among the most closed agricultural markets in the world. Those now represent some of our largest export markets. We have gotten Japan to eliminate its quotas in those areas. And in the recent Uruguay round on rice, we got Japan to multilaterally agree to begin the process of liberalization there.

I should point out, however, that while we used a domestic instrument, section 301, we also effectively used the multilateral system. The beef and citrus cases were cases that we brought to GATT dispute settlement, and the rationale the Japanese eventually used with their own citizenry for beginning the process of liberalization was that the multilateral rules required them to move in that direction.

I am simply suggesting that this instrument has to be taken in the context of a broader system rather than a pure reciprocity mechanism. I think that is very important. I think that is the in-

tent of the administration. And we have demonstrated that where we effectively use both bilateral and multilateral pressure, we can achieve the most comprehensive results.

Chairman NEAL. Thank you, sir.

Mr. Leach.

Mr. LEACH. Thank you, Mr. Chairman.

I think, Mr. LaWare, some of your points are very important to take into consideration, but I would stress that this particular bill has gone through a number of drafts. I think it is not as heavy handed, as would indicate the implications of some of your sentences on page 2. For example, there is no hint that current powers of currently existing banks in this country will be cut back with the passage of this bill.

Philosophically, you may be right, that market forces eventually work. But market forces only work where market forces are allowed to work, and a number of countries in the world do not allow market forces to work. And so the great question is: Are there times and places and appropriate ways and techniques to achieve objectives?

And here let me tip my hat to Mr. Schumer and Mr. Neal, both in this bill and in past legislation. After all, if you take the example of Japan, I don't think there are many people in the security industry that do not think that the Primary Dealers Act didn't have something to do with Japan on a more timely basis opening up some of its markets. And that has nothing to do with market forces in and of themselves. It had to do with the sheer fact that public policy in some countries constrains market forces, and there is a role for government to do something about that.

I have several concerns that I would like to address to the two people from Treasury and USTR. One question relates to an aspect of the financial industries market, and that is the insurance industry.

Which of your two jurisdictions is going to have the primary role and mandate to work in that area? Given the fact that the insurance industry is primarily, if not virtually exclusively, regulated at the State level, how is it that we can bring responsible kinds of comparable efforts to bear on insurance?

Would you care to comment on that, Mr. Summers and Mr. Yerxa?

Mr. SUMMERS. Traditionally, insurance, because it is less linked to the payments mechanism, has been separated in the process of negotiation from other financial services. And while Treasury has had responsibility for banking and securities, USTR has had responsibility for insurance. That also reflects the difference between the regulatory patterns that you referred to.

In this legislation, as drafted, we have continued to respect that separation. Section 301 actions have been used in the past with respect to insurance. We feel section 301 is a more viable tool with respect to insurance; and, therefore, there is less need for it to be included in this Fair Trade in Financial Services legislation.

So in the bill that the administration has supported, insurance is not included within the ambit of the legislation that would be applied.

Mr. LEACH. But that does not imply that it is not on the horizon as a major issue of your Department.

Mr. SUMMERS. Pardon me?

Mr. LEACH. That does not imply that it is not a major concern to your two Departments, does it?

Mr. SUMMERS. I don't think there is any question that, if one looks at any number of emerging markets and if one looks at Japan, there are very important issues in the next few years in insurance.

We are involved right now in a major negotiation with Japan, up against a February 11 deadline, in insurance, because insurance is one of the key sectors under the framework agreement with Japan where it was agreed last July that we would be seeking—along with auto parts and along with public procurement—agreements prior to the heads of State meeting between President Clinton and Prime Minister Hosokawa.

So the administration is very determined. There are probably a dozen people in Tokyo right now negotiating on the things we need in terms of opening the Japanese market.

Mr. LEACH. Well, I am pleased to hear that. And I would also say if we do not see progress, you are likely to get comparable, in fact, in all likelihood, stiffer framework legislation on insurance than you have proposed here in banking and other sectors of finance. I think that is a common sense circumstance.

I would like to conclude, though, with the observation of Mr. Yerxa. I fully agree with you that you need multilateral frameworks as well as bilateral. And multilateral frameworks, in many ways, have a more open prospect than some bilateral. On the other hand, I must say there is a sense of disappointment—even though Mr. LaWare is correct, that the financial services issue is still open, there is a great deal of disappointment that nothing occurred in financial services.

It is very significant in the GATT circumstance to date. I would simply stress as strongly as I can, that as much as all of us appreciate the efforts of the administration on behalf of the movie industry, which did not prove to be too successful, that you do not put financial services on a lesser level.

And as an outside observer of the GATT process, I must say it looks to me as if the United States put an awful lot of weight behind one set of negotiations which were unlikely to be successful and not enough weight behind another set of negotiations where there was much more potential consensus; that we did not give as much weight to financial services as this administration gave to the movie industry, we may fail.

I would hope that this would be understood as a very, very high priority and that financial services should be looked at as broadly and as forthrightly as possible. And I urge you to seek that multilateral avenue, which I agree with you is, in the long term, much more significant.

Mr. YERXA. Congressman, I can certainly understand how reading a lot of the reporting and press accounts on the closing hours of the negotiations it certainly seemed as if there was greater emphasis on the one than on the other.

I think, in part, though, that was dictated by the fact that it was a more visible and a more interesting issue for the press to report on and that it was a United States-European dispute which led to quite a few sparks in the European press. But I do not think it would be fair to say that we placed less emphasis.

I think, throughout the entire process, both Treasury and USTR placed a good outcome on the financial services commitment really as the most important aspect of a good financial services agreement. The reason we did not want to agree to a conclusion of the negotiations on access together with a commitment from us on MFN at the December 15 meeting was that we had not achieved sufficient results and we were not willing to condone a result that had the United States making an MFN commitment with other major countries as free riders in that system.

But I certainly share your view that this ought to be the highest priority. It is, for us, one of the most important criteria of a successful multilateral agreement.

Mr. LEACH. Well, I appreciate that. But my time has about expired, and I want to add a 10-second comment.

The most unseemly political event of the last year was that, in the major last minutes of the GATT negotiations, a significant fundraising event occurred in Los Angeles. And I just ask you, for the sake of decency and seemliness that at no point in time will there be comparable fundraising pressure put on the American banking system while financial services are considered under GATT.

Thank you, Mr. Chairman.

Chairman NEAL. Mr. Schumer.

Mr. SCHUMER. Well, thank you very much, Mr. Chairman. I want to thank you, Mr. Chairman, for holding this hearing, and then Mr. Frank and his subcommittee for moving the bill, as well as Mr. Leach for his support.

Just briefly, for Mr. LaWare. I must say I find your comments sort of from Never-Never Land. You know, this is nice, theoretical—with no offense intended to you, but maybe to the remarks. This is nice, theoretical construct that has nothing to do with reality.

You admitted no American bank can buy a Japanese bank. Let's say that the markets forces that you wish to rely on just somehow don't get factored into the political system. Let us assume that the bankers in Japan are able to control the governmental decision-making process more than the people. Given what we read about what is going on there now, that might be true. But let us make that for assumption's sake. Would you then support legislation like this?

Mr. LAWARE. Well, that is a big——

Mr. SCHUMER. Let's say it is a dictatorship of the banks. Let's say the head of Tsumi Tomo Bank was the Prime Minister of Japan and there was no Diet, no Parliament, and he said we are not going to open up to America anything, would you still say this legislation is bad?

Mr. LAWARE. I suspect that over time he would be brought down because he was not recognizing what is going on.

Mr. SCHUMER. Maybe over time you will be brought down, I don't know, to reality. This is not reality.

Mr. LAWARE. The market force answer to your question—or to the question about buying banks in Japan is that if the banks in Japan need capital and do not have domestic sources of it, that will force the change in the decision. And that could happen perhaps in the near future.

Mr. SCHUMER. Maybe they could get capital in other ways. Maybe they can get the government to infuse capital into them without requiring extra competition.

Mr. LAWARE. The United States has clearly been a model for the benefit of an economy by the injection of foreign capital; and if the Japanese are economic realists, they may well decide that the attraction of foreign capital into their system is a good public policy.

Mr. SCHUMER. Let us assume they are not economic realists or that the model does not work.

Mr. LAWARE. You are making me accept your assumptions. I am just trying to suggest some others.

Mr. SCHUMER. Let me just say one point, Mr. LaWare. I don't want to get into a lengthy debate. As you know—I mean this seriously, and I hope you will bring this message back to the Chairman and others—there is a great dispute now about regulatory reform.

One of the reasons I have been more friendly to the Fed and resisted some of the entreaties of the Treasury, is that I think to have a different regulator deal with the international situation makes some sense. Your comments make me rethink my position.

Because one of the reasons I would think we need an international regulator as opposed to just another is—and we saw this in the Basel accords and other types of things—that to keep our institutions internationally competitive, sometimes you may need to look at things a little differently than if you were just looking at a bank that was just doing domestic business.

But if the Fed's attitude toward something like this—and I am not asking for a quid pro quo, it is just indicative to me—is this model—this very academic model, which all of us use as the way to see the world and all of us, when we first studied this, found initially attractive—it just does not fit. You have to discard models or modify them when the factual realities depart from them. I have real doubts whether the Fed should be an international regulator.

You do not need to comment on that.

Mr. LAWARE. Well, I would like to comment on it because I think this is basically an economic issue. It has nothing to do with the safety and soundness of the U.S. banking system, which is the primary responsibility of regulation.

Mr. SCHUMER. One of the reasons some of us—the argument some of your cohorts at the Fed have made is that you need a different system for banks that are internationally—of regulation for banks that are internationally competitive. And we did find that in the Basel accords. We found if we were to impose the same standards on our institutions as on the Deutschebank or the banks—not the Deutschebank. Well, Deutschebank or any of them, would put our people at a competitive disadvantage.

I want to go to Mr. Summers and Mr. Yerxa, who I also find soft on this issue. But you bring me back to reality, and I appreciate them a little bit more.

Can you just give us a thumbnail sketch. I was extremely disappointed in the results of the GATT negotiations. Yes, we did well in manufacturing; but the place where the United States is way ahead of its competitors and adds market value more than anywhere else is services. And all of a sudden, services is taken off the table. We have some gives and some not in the manufacturing area. But from my point of view, GATT was not a great success because of the failure to include services generally.

Why were services excluded? Was it opposition? Just give me a general answer there. Obviously, you wanted to include it, and it was regarded as a defeat for the United States that it was not.

Mr. YERXA. I would not agree with your overall assessment that services was a failure. I understand the point that you are disappointed. In fact, we are all disappointed with the commitments that were on the table on financial services, which the United States decided were not adequate commitments to completely resolve the negotiations.

The tradeoff would have been for us to commit ourselves to an unconditional MFN principle in the GATS in exchange for the commitments that were on the table.

There were, from a number of countries, some very good financial services commitments on the table. But with respect to many of the countries that we are most concerned about, clearly——

Mr. SCHUMER. Were any of those countries East-Asian countries?

Mr. YERXA. There was some proposed commitments on the table from some of them but, as I say, not enough.

And the point here, Congressman, is that what we resolved—what we did in resolving the negotiations was to insist that there not be that tradeoff, that we have the leverage to negotiate in the future, that this legislation frankly helps us with.

But I don't think you should write off the entire result because, first of all, the framework itself is a sound framework. And, second, in numerous other sectors of services trade we do find good commitments which are going to help form the basis of a system that the United States, through some enlightened leadership, can turn into a more complete system.

Now——

Mr. SCHUMER. Can you be a little more specific? Where was the resistance in terms of going further in the financial services area? Where was it from?

Mr. YERXA. I will also ask Under Secretary Summers to comment on this because he was very active in the negotiations with me. In fact, Treasury was taking the lead in the bilateral sessions. But clearly the results from Japan and from many of the Asian countries were inadequate; and we stated that over and over again repeatedly with them and publicly.

Mr. SCHUMER. Mr. Summers.

Mr. SUMMERS. Let me just say, Mr. Congressman, the United States' position from the time the Clinton administration came into office was that we would maintain the ability of the United States

to take an MFN exemption unless and until sufficient commitments were forthcoming.

Frankly, it was the position of most people outside the negotiation, particularly in the industry, that that position was disingenuous, because it was felt there was no real prospect that sufficient commitments were going to be forthcoming and we might as well just keep our MFN exemption. We were determined to make every effort.

My Assistant Secretary, Jeff Shafer, spent 2 weeks in Asia in the middle of November seeking to make every effort. I was involved in extensive dialog with the Japanese. We arranged, to some degree, to coordinate efforts with the European Community to pursue our concerns in a number of the emerging market countries. Ultimately, we did not get where we wanted to go. There were, to be sure, some commitments that were made.

We have gotten a crack into the Japanese asset management market, not nearly as large as we wanted. We have seen significant expansion in bank branching in India and in a number of other countries. We have seen commitments to reduce restrictions on the ability of our securities companies to make acquisitions in a number of the emerging market countries.

So there are commitments that came in the round, and those commitments are worth harvesting. And the approach we have taken enables us to harvest them.

Those commitments, frankly, fall very far short of what the United States was trying to achieve, which is the kinds of things that were achieved in the NAFTA Agreement, which is a commitment to—over time—a movement to national treatment, to equality of competitive opportunity. And that is why, in the end, the judgment was a clear one, that the United States needed to maintain its ability to take an MFN exemption.

And that is what we were able to achieve, and that means we are able to pursue the more aggressive kind of approach that this legislation makes possible. That is why it is so important that this legislation pass.

So I would say that one's view of this has to depend on at what point one came into the drama—and you certainly came into it much earlier than I did. As of some point it may have been a realistic goal that we would see far-reaching commitments to national treatment in most of the markets, and could bring the GATT round to a conclusion around that principle.

Frankly, in the period running up to it, that was certainly a hope, but it was never an expectation that we had. And that is why a great deal of our strategy focused on maintaining the capacity to use leverage. That was what was behind the so-called two-tier approach that played an important role at one stage in the negotiation.

So I think that, relative to where many expected this to end, I would say we certainly have a qualified success here in that we have an approach that enables the United States to go forward, in which the United States has not sacrificed important leverage, and has, at the same time, made some progress.

Mr. SCHUMER. Mr. Chairman, I have other questions, but I know Mr. Frank has waited; so if we could have a second round, I would appreciate it.

Chairman NEAL. Mr. Frank.

Mr. FRANK. Mr. LaWare—and I discussed this before—I would just say that as a strong supporter of the administration's position on amending the regulatory standards, given what Mr. Schumer said, maybe I am less eager to have you change your position now.

But I would like to ask Mr. Yerxa some questions, because one of the issues that has come up here—and I found support for among my colleagues; and with the support of Mr. Leach and Mr. Schumer, we have some bipartisan approaches—the subcommittee I chair, which shares jurisdiction, has already moved on this—but jurisdiction is the issue. Because one of the questions we have been dealing with, as we try to move on this, is the leadership among the executive agencies, including the Trade Representative, Securities and Exchange Commission, the banking regulators. And that gets us into jurisdictional questions even within the Congress, where you have three different committees in each branch that deal with that, or two in the Senate and three in the House.

So I am particularly interested, Mr. Yerxa, in your view, representing the Trade Representative—and I gather this is official—and the whole trade complex, which includes the Ways and Means Committee, as to what you think about the jurisdictional approaches here.

I take it you are satisfied with, in this case, lodging the authority with the regulators, who regulate the activity, rather than giving it all to USTR?

The norm in other areas is the Trade Representative would have some of these triggers. But I take it your position is that because of the complexities of bank regulation, or securities regulation, to the extent that would be involved, it is important that this power rest with the fundamental regulator in each case?

Mr. YERXA. Congressman, this is something that we have had an extremely vigorous dialog on within the administration, and I think I should say a productive dialog, because it does not—at this point, I don't see major jurisdictional differences.

When we began the discussion within this administration about our position on Fair Trade in Financial Services, we started from the assumption that there is always available under U.S. law a mechanism called section 301, which is a broad mechanism that enables us to deal with other governments on a wide range of issues.

And if you look at section 301, it is very broad in its authority. It covers not only goods but services, and it provides a wide spectrum of retaliatory devices.

But there was a view that we had a particularized problem in this sector and that we needed a more fine-tuned surgical instrument to deal with some of these financial services market problems.

We are fully in accord with the proposal in the legislation to have these decisions made by the Secretary of Treasury with regard to financial services action but have proposed and have discussed the need for a consultation mechanism within the administration. I

think that would be the prudent thing to do in any case where this kind of action against another government is being contemplated. It is certainly the case in section 301. And where the U.S. Trade Representative ultimately has the decision in 301, it only occurs after a full consultation within the government with all the affected agencies.

The other point about the regulatory framework here is that there are some differences between the different sectors or subsectors; and that is why, as Secretary Summers has said, insurance can be handled appropriately under section 301.

We draw a distinction there. But certainly taking into account the concerns of the regulatory agencies is an important part of this process, and I think this legislation has to ensure that that is done.

I don't see at this point any real jurisdictional problems between us over how this mechanism can be fashioned in a manner which would be highly effective in achieving the pressure that is going to be needed.

Mr. FRANK. Thank you.

Let me just ask Under Secretary Summers a question—an economic question in commemoration of the medal—congratulations—which is the argument that I think we are getting in opposition.

It seems to me to represent at least some of what the Federal Reserve Board is saying and that is that cutting through of all this, even if other nations, Japan or others, keep our financial institutions out, the value of competition and additional resources is such that we still, as a nation, should allow them in; that, in fact, we benefit from their bringing their capital here, they are providing an increased range of services.

And even if they are restrictive and, therefore, damage their own economy, we should not ever engage in any reciprocal activity of keeping them out because we are hurting ourselves. How do you address that?

Mr. SUMMERS. Well, it seems to me that this whole question of the use of leverage in financial services and in other issues is one that you have to think very carefully about.

If, like me, you are an advocate of free trade, if I thought this measure was going to be totally ineffective, if I thought what the United States did would have no affect on access to financial markets for U.S. firms, I would then say, yes, we probably are better off with access to foreign capital. If it does not and we are better off, it is too bad our firms do not get access, but we are better off with the access to foreign capital. So if retaliation was totally ineffective, then I would say we were better off not engaging in it.

However, it seems to me that that sets our sights too low, setting our sights too low in the sense that if we have leverage and we use that leverage intelligently, then we can produce the best of both worlds: The threat will be effective. And when the threat is effective, we will succeed in getting increased access to foreign markets. And at the same time, we will not find ourselves retaliating with great regularity; and, therefore, we will not sacrifice, to any significant degree, openness in our market.

But there is always that dilemma in the use of leverage. In this case, frankly, it does not seem to me to be a very severe one.

Mr. FRANK. So the intention of the administration would be that if we did grant this authority, you would not be using it to enforce, sort of an automatic reciprocal situation—whatever they have, we would have—but it would be part of an effort to influence where they were over there—although, obviously, that game theory multiplies, because if they thought you were not going to be rigid, they might not be so easily moved.

But the intention you say is to use this in a way it will affect their——

Mr. SUMMERS. One of the three or four principles I mentioned and the way we wanted to see this legislation crafted and the way H.R. 3248 was crafted was that there was no automaticity, that there was the discretion; and that was precisely to enable us to use the game theory in a way that ensured that the outcome would be advantageous to the U.S. economy.

Mr. YERXA. Could I comment on that?

Mr. FRANK. Yes.

Mr. YERXA. I have had some experience with the use of this kind of leverage. And when you actually get down to the question of what kind of action are you going to take, the situation does change somewhat. The experience we have had under section 301 is that when you get to the point of actually having to retaliate, very often you are engaged in more of a damage control exercise than you believed and you are finding that you have to weigh the adverse effect on your own interests.

We have certainly had situations where people who have been strong advocates of retaliation, once we begin publishing a list of tariff items for retaliation, are writing to us saying, "take me off the list."

But my point here is that, nevertheless, you have to have that potential in order to create the conditions to get a deal.

Mr. FRANK. Let me say in that regard, I think the way this bill was drafted—Mr. Schumer confirmed this—I think some of that problem is alleviated by the facts of the grandfather. That is, oh, my God, I already have this established relationship; don't disrupt it. That is much more likely than the situation here where we are saying, OK, what is happening is happening; but we will prevent you from doing anything new. You were, then, less likely to get that internal lobbying effect.

Mr. YERXA. Yes. Prospective use of this certainly helps in that regard. But the other point about strict reciprocity, I think we have to be careful here because we would certainly not—you know, I remember the debate with the Europeans over the banking directive, and the concern there might be a strict reciprocity directive applied to our banks in Europe was something our financial services committee was not terribly enthusiastic about if they began imposing the same kinds of automatic regulatory restrictions on our banks that we apply on their banks.

So we do have to be careful that we do not substitute reciprocity for national treatment. That, I don't think, is the purpose of this approach. The purpose of this approach is to gain fundamental fairness.

Chairman NEAL. OK. It is to gain market opening, I believe; isn't it? It is to open markets.

Mr. YERXA. Yes.

Chairman NEAL. What would you all think about delaying the effective date on which the sanctions could be imposed until after we know whether or not the GATT negotiations would be successful? That would make it clear that our intent is to open markets. I think it ought to be clear anyway. I am not saying that we are sending any separate messages on that, but that would—delaying imposing any sanctions until the negotiations are complete, would be 100 percent clear.

Mr. YERXA. I would argue this is something where you ought to give the administration some discretion to adopt that kind of approach. We may find, in a particular circumstance, that we need to move more quickly than that; or we may find that gearing it toward a particular deadline in the multilateral negotiations would assist us. I think we ought to have some latitude in that regard.

Mr. SUMMERS. I would agree with that. I think there is an important window of 18 months now until the 6-month period after the GATT goes into effect when we plan to negotiate and to negotiate aggressively. And without this tool, I think we would be weaker. We would be in a weaker position during that period. I think it is safer to provide us with the discretion as we negotiate forward.

Chairman NEAL. OK.

Mr. Leach, do you have anything more?

Mr. Klein.

Mr. KLEIN. I have no questions.

Chairman NEAL. OK.

Mr. Schumer.

Mr. SCHUMER. Yes. Thank you. And I just want to underscore, I think, one of the most important things that was said today is that Mr. Yerxa's office and the Treasury have come to an agreement about who should regulate. That is a big breakthrough. And I would hope Congress can follow your lead on that as well. And I know Mr. Frank has been endeavoring to do that as well.

I would like to just continue a little bit, a little on the more theoretical side on this because I still have a great deal of trouble. This is my bill; so, obviously, I support it, and I think it is a good first step. I am still troubled by the whole thing.

I guess I put, more than you, Mr. Summers, in the value scale, I see a real threat to free trade in the world from countries that really—I have become convinced over the last several years—do not believe in it, that they game the system as much as they can and they really do not believe in free trade.

It is not simply infirmities in their own political structure, that if nobody said a peep back home, they would still do most of the things that they are doing because they have a more mercantilist-type view that the accumulation of wealth and capital in the government and in the companies is more important than the standard of living of the people; whereas, our view—our free trade view is really—and yours, not that different than Mr. LaWare's—is that the consumer benefit is really very, very important.

I am somewhere in the middle of that. I am not so sure the mercantilist view is totally against the people's national interest. I think it is somewhere in between; that if wealth were to continue to flow out of the United States for a very long period of time, be-

cause our overall balance of trade were quite severe, that it would hurt our standard of living not in the immediate but certainly in the long run.

So my question is this—and I do want to compliment you on coming to that agreement on Treasury. I think that is probably the most important thing that will be said here today, not anything else I have to say on this stuff. And I also completely, by the way, agree with you and Mr. Yerxa and would defer in deference to my chairman, Mr. Neal, I think to take away this lever now to make a symbolic point, oh, yes, we are really for free trade, everyone knows in financial services.

I don't know what we have done to restrain other people from coming in at all. We do not need to make that point and take away the leverage of this with that 18-month window period. Are we perfect? No. But we are so much closer to perfect than just about anybody else, I don't think we have to make the point.

My question is this, and it is a general question, and I would just like both of your views on it: If we are limiting ourselves to the area of financial services where clearly we have a real advantage, I mean let us just assume arguendo for the moment, that we are the best in banking and securities and insurance, that technologically and marketing and everywhere else overall we have a big lead over everybody else, and we are saying to other countries, well, the only way we are going to exert leverage is by preventing you from doing new things here, in an area where they are admittedly, technologically and other ways, way behind us, what kind of leverage is that?

I mean, if I had my druthers, I would want cross-sector stuff, not just between banking and financial or securities or between insurance and banking; but in places where they are technologically superior to us, where there are many, that seems to me where we have real leverage. That seems to my instincts—and it is nothing more than instinct—is that that would work.

And, you know, I know that our companies—I learned this when I did the original act in 1986, which I would still say has done more to open up financial markets and it has not done it much, than just about anything else, our companies are all afraid. They are very short term. They are not interested in the national interest. They are not interested another competitor might get in and do something overseas where they have a little niche in the market. Yeah, they are always saying, go slow. I found that. I found everyone said, oh, what company was pushing me to do the primary dealers thing? None of them. They all said, slow down, we are worried Japan will retaliate against us one way or the other.

So my question to you is: What kind of leverage is this? And why—theoretically speaking, I am not drafting another bill or changing the amendments to this, what would be wrong with increasing the leverage?

And the only way to increase the leverage is either go back on existing financial services, not have the grandfather, which I probably wouldn't, or do that leverage in other areas where we have a technological disadvantage; where they have huge balances of trade surpluses with us? That seems to me to be really where we ought to be headed.

Go ahead, Mr. Summers.

Mr. SUMMERS. I think your question is a fair one, Mr. Congressman. I would not underestimate the degree of leverage that this bill, in its current form, provides. I think a number of these countries do have aspirations of entering our financial markets less because they think that they are going to technologically compete with our major firms than because they have a certain number of firms doing business in manufacturing and other firms doing business in the United States and that gives them a niche that they could enter. So because of that, I think the leverage that it provides is a little bit more real than a simple observation that they were backward would suggest.

Second, I think it is important to understand that, just as our government is not a monolith, these governments are not either, and that the principal parts of these governments that we are trying to influence are the parts of the government that are involved in financial regulation. They are not likely to be so sensitive or responsive to what we do in nonfinancial areas.

I can tell you, from having participated, along with Mr. Yerxa in the GATT negotiations, that the degree of harmony you are witnessing between the Trade Representative and the financial people, as well as being somewhat historically uncommon by American standards, is also extremely uncommon by international standards, and that the standard posture of people involved in granting securities applications is one of utter indifference to what happens to their country's textile exports.

So I think you are somewhat overstating the efficacy of cross-sectoral retaliation.

Mr. SCHUMER. I accept that, at one point, you get the textile people going and screaming bloody murder and they seem to have more clout—not textiles per se, but let's say you did electronics or automobiles or something like that; they seem to have more clout over the government than the financial services people do.

Mr. SUMMERS. Here, you mean?

Mr. SCHUMER. There.

Mr. SUMMERS. Perhaps. I think dealing with the financial regulation, I think dealing with the financial regulators, we have an instrument that is tied to them.

The third point is one that you referred to, which is that, frankly, many in our industry, many parts of the financial services industry, have expressed very grave reservations about the use of cross-sectoral retaliation.

One of the virtues of the bill that has been crafted in its current form is that it is supported across the board by the financial services industry; whereas previous variants have received significant opposition from large components of the financial services industry.

The last point I would make is that section 301 is, of course, on the books. And it, of course, would, in principle, allow for the use of cross-sectoral retaliation.

And one of the important virtues of this bill is its more surgical approach. That rationale is undercut somewhat once one moves to talk about expansive kinds of cross-sectoral retaliation.

So I would agree with you, it is a difficult balance. I would admit the possibility that if we were all here 5 years from now and we

had made very little progress that one would want to take a look at some more expansive proposal. But in terms of increasing the pressure at this point, I think that striking the kind of balance that we have here, with the fairly unanimous support, to have support of the industry, is the right way to go.

Mr. SCHUMER. The only point I would make, Mr. Summers—and I have a great deal of respect for your integrity—but 5 years from now is now for me. I was there 5 years ago; and what will happen, I worry, is we will get, not a new administration, not even a new administration, but even new people in the same administration. We relearn this curve all over again. I mean, I could choreograph everything you are saying with the last guy and the guy before that and the person before that. And that is one of the problems we face in that you know you face a parliamentary system of government, those people have been there forever and they continue along.

My guess is we will be here. I hope this legislation works. I have spent a good deal of time on it and drafted it to be passable and not get anybody too upset. But my guess is we will be here 5 years from now unless the kinds of reforms that we are beginning to see in Japan—I thought the best news was the markets, the Japanese Stock Market, and others reacted so positively to reforms. That may break things open more than we do. Market forces, Mr. LaWare, I do have my hat off to you.

But, anyway, that is the problem. I bet if you stay in this job 5 years from now, you will be supporting the kind of cross-sector retaliation.

Chairman NEAL. Yes, sir, Mr. Yerxa.

Mr. YERXA. I wanted to just make a couple of comments, and I don't mean to belabor the session. I know you have other witnesses.

But I want to say, first of all, that I do share what Mr. Summers has said about the almost unique degree of cooperation between our two agencies.

And as he said, that is not always the case with other governments. I can't remember the English—the German word, but the German Finance Ministry officials have a wonderful derogatory term for trade officials which translates into little boys in lederhosen.

So it is certainly not always the case internationally that Trade and Finance Ministry officials get along so well. But I think more importantly than that is the point that we see a common problem and a common means to address that problem.

And I want to go back to something you said, Mr. Schumer, because I don't fully share your view that what we are facing out there is governments all over the world that have a purely mercantile attitude. Maybe I am exaggerating.

Mr. SCHUMER. Not all over the world but in certain portions of the world, yes.

Mr. YERXA. But I think even in those places what we are witnessing is a trend toward opening and liberalization which is very important to reinforce.

And the reason I would be cautious about taking a too unidimensional view about what came out of the Uruguay round in

this sector is you have to view it against the overall perspective of liberalization that is occurring in the Uruguay round. We are seeing country after country committing itself to remarkably low levels of import tariffs and binding those in the GATT. We are seeing them taking on commitments to abolish nontariff restrictions, things like import licensing and customs valuation. We are seeing them committing to not using investment restrictions, like local content requirements.

And I would argue that the more they liberalize those aspects of their economy, the more difficult it is going to be for them to keep an obsessive regulation and restriction of their financial sector. And these are mutual reinforcing trends.

Mr. SCHUMER. Do any of those examples, the tariffs and the local content, apply to Japan?

Mr. YERXA. Yes. Absolutely. But my point here is——

Mr. SCHUMER. Which would? Educate me a little bit.

Mr. YERXA. All of them. They have made about——

Mr. SCHUMER. Not what they legally apply to Japan but how much do they actually, de facto, mean to Japan tariffs, don't mean much to them in all areas.

Mr. YERXA. They mean a great deal in reductions in tariffs where it is still a significant barrier in Japan. I am not suggesting that is the sole answer to liberalization of Japan's economy. I am suggesting the more reinforcing of those trends through this international system, the more difficult it will be for them to maintain a highly restrictive financial sector; the more they will face the same pressures that we are facing in a globalized economy to internationalize those sectors and that we would really be making a serious mistake if we do not recognize that that will have as great an impact as any mechanism we devise here.

That is not to suggest we should not have the mechanisms. And there I want to go back to your last comment about the breadth of this authority. We do have section 301, which has been used effectively in the past, including in the financial sector.

Frankly, we do not have a long line of industries outside USTR lining up to file 301 actions right now. We do not have them coming in and saying you have to bring a case. We do not even have them coming to us quietly and saying that. Why is that? I think they have some hope that these other negotiations we have under way are going to achieve results. And I think many of them are realistic about whether you can actually utilize a retaliatory mechanism in the final analysis unless you have a very precise objective, unless you have a specific case, a specific issue where that mechanism is effective.

And I think with Japan, that is the case in financial services and even with these other countries which might not have as great an interest today in our financial markets as we have in theirs. Five years from now, I think that situation is going to change. A number of these countries are developing international banking sectors, and I think the use of this tool will be meaningful in that respect.

Chairman NEAL. Mr. Frank.

Mr. FRANK. Just briefly on that last point. There will be, if we get through it, and I hope we will, some interest in following it up. And we also worry about it being under used. And I think some

retaliation in extreme cases could be very important. You have, obviously, some skepticism here about whether or not people really ever will push someone to the end.

And I would say, you talk about the need for kinds of normal, perfect cases before you retaliate. There is something to be said, in cases where you have a government that is really an offender of retaliation, even if you are not sure it will work against that government, but to let other people take a look at it and see the impact. I think that from the standpoint overall of reaching free trade goals domestically as well as internationally, a willingness to retaliate against latent offenders of fairness is a very important thing.

Mr. YERXA. I fully agree you have to be able to demonstrate to your trading partners that you mean business. Otherwise, I will not get results.

Mr. FRANK. Retaliation does not have to work case by case to work as a policy overall.

The only other point I want to make, Mr. Chairman—and it is only peripherally related here—but internationally things do have relevance. I just wanted to say a word about the chairman of the full committee and one of the useful things he did.

The last time I was in the room I think was when we were having a hearing about whether or not there should be a grant by the State Department of immunity for the head of Kuwait, was it? No, Abu Dhabi. For the sheik of Abu Dhabi with respect to BCCI. And we had a hearing in which a number of us expressed great skepticism of that.

And subsequently a system was reached in which the request for immunity became moot. And I think the hearing was probably helpful in that. And I would like to say—I know Mr. Leach was there—that I want to congratulate the chairman for his having that hearing. And I say that literally because sometimes people regard congressional intervention as a plague; that if they just hunker down, it will just go away. And here was a case where the chairman had a hearing where the people told him not to have a hearing, and yet I think the hearing had a hand in helping give the sheik immunity as to his role in being a bank owner which helped us get a system.

Thank you.

Chairman NEAL. Any other comments?

Any of our witnesses like to make a closing comment?

If not, thank you all very much for being with us. Stay in touch with us on this. We welcome your thoughts.

The subcommittee stands adjourned.

[Whereupon, at 11:15 a.m., the hearing was adjourned.]

APPENDIX

February 1, 1994

OPENING STATEMENT OF
CHAIRMAN STEPHEN L. NEAL
ON H.R. 3248,
FAIR TRADE IN FINANCIAL SERVICES ACT
FEBRUARY 1, 1994

This morning the Subcommittee meets to hear testimony on H.R. 3248, the "Fair Trade in Financial Services Act." This legislation was developed by the Subcommittee on International Development, and reported prior to the conclusion of the recent Uruguay Round of GATT negotiations. It was intended to help induce other countries to reach an agreement on financial services, as part of the GATT, under which all countries would offer "national treatment" to foreign banks and other financial firms operating on their territory. That effort, so far, has failed.

National treatment means that the host country treats foreign banks the same as its own banks. It offers them the same rights and privileges, and subjects them to the same rules and regulations, without discrimination. It also means, as defined in this legislation, that foreign financial firms enjoy fair access to their markets.

The United States has traditionally adopted something close to national treatment as its basic norm. National treatment has been the objective of our GATT negotiators on financial services. This legislation, however, explicitly authorizes discrimination against banks and securities firms from countries that deny national treatment to U.S. banks. The Administration supports it in the hope that the threat of retaliatory discrimination will finally persuade other countries to open their financial markets to U.S. firms, and treat them fairly.

Most other industrial countries do offer national treatment to U.S. banks. The major exceptions are Japan, and a few so-called "emerging market" countries. They apparently refused, in the recent GATT negotiations, to commit themselves to a full opening of their financial markets.

That is not, however, the end of the story. The Uruguay Round was officially left open on financial services, with ample time to complete a satisfactory agreement and incorporate it into the GATT. If we succeed in obtaining satisfactory national treatment in the upcoming, and presumably final, phase of negotiations on financial services, the sanctions authorized in this legislation will not come into play. If not, we will be in a position to depart from our historical practice, and discriminate against any foreign country that denies national treatment to U.S. banks.

I would like for today's hearing to focus on a few issues:

(1) The status of the GATT negotiations, including the major countries that are resisting the adoption of national treatment, and their importance for U.S. financial firms.

(2) The role of the Secretary of the Treasury in determining the possible imposition of sanctions.

(3) The question of "cross retaliation," that is, the imposition of sanctions against foreign banks if the foreign country discriminates against U.S. securities firms, or vice-versa.

(4) The timing of the sanctions: that is, would it not be advisable to postpone their possible implementation until such time as the final phase of GATT negotiations on financial services were to definitively fail. This approach would make it clear that the purpose of this legislation is to help reach a satisfactory financial services agreement, and that discriminatory retaliation is a last resort.

And, finally:

(5) The general objection raised by the Federal Reserve against this type of legislation. As I understand that objection, it might be phrased like this: "We benefit considerably from the economic contributions foreign banks make in our markets, and we would simply be denying ourselves those benefits if we discriminate against those banks."

Our witnesses today are:

The Honorable Lawrence H. Summers, Under Secretary for International Affairs, Department of the Treasury

The Honorable Rufus H. Yerxa, Deputy United States Trade Representative

The Honorable John P. LaWare, Governor, Board of Governors, Federal Reserve System

Statement of James A. Leach
Subcommittee on Financial Institutions Supervision,
Regulation and Deposit Insurance
Hearing on H.R. 3248
"The Fair Trade in Financial Services Act"
February 1, 1994

I want to thank Chairman Neal for holding this hearing today on H.R. 3248, "The Fair Trade in Financial Services Act." This legislation was introduced by Rep. Schumer and myself to open up foreign financial services markets to U.S. banks and securities firms. Identical legislation was also introduced in the Senate as S. 1527 by a majority of the Senate Banking Committee, including the Chairman and Ranking Republican.

This bill is supported by the Administration and all major banking and securities groups, including the American Bankers Association, Securities Industry Association, Independent Bankers Association of America, Bankers Rountable, Bankers' Association on Foreign Trade, and Investment Company Institute. Last November, the International Development Subcommittee reported out a modified version of this bill, and it is my hope that this subcommittee and the full Banking Committee expeditiously will do the same.

This legislation has become even more important given the recent conclusion of the Uruguay Round of the General Agreement on Tariffs and Trade (GATT). Last week, Congress received a letter signed by both Treasury Secretary Bentsen and U.S. Trade Representative Kantor, noting that while the Uruguay Round agreement will be helpful to ensuring prosperity of American industry, the financial services segment of the agreement was more modest. The Administration officials also go on to say "that enactment of the Fair Trade in Financial Services legislation is needed at the earliest possible time to safeguard the progress we achieved in the Uruguay Round and to support additional market opening talks, both within the GATT framework and on a bilateral basis."

While not without blemish, the U.S. can boast of having the most open, honest, and efficient banking and securities industries in the world. These attributes have made the U.S. a net exporter of financial products. Because of past U.S. leadership, the financial markets in many other countries are also becoming more open and accessible. However, problems still exist in certain foreign markets with U.S. commercial and investment banks still being discriminated against.

In the most recent National Treatment Study prepared by the Treasury Department, Brazil, Korea, India and Taiwan and many others were specifically cited as not providing national treatment to U.S. financial firms. One of our most important trading parties, Japan, was also cited as being relatively closed

to U.S. banks and securities firms despite more than a decade of bilateral negotiations on market access. Hence, Congress has little alternative except to enact this legislation.

H.R. 3428 is patterned after the Primary Dealers Act of 1988, which became part of the 1988 trade bill. This act successfully has gained U.S. financial firms access to the government securities markets in other countries. H.R. 3428 incorporates into the International Banking Act the concept of reciprocal national treatment -- that the U.S. will give equal treatment to a foreign bank if that bank's home country gives equal treatment to U.S. banks. Reciprocal national treatment is also made part of U.S. securities law.

Under H.R. 3428 and S. 1527, bank regulators or the SEC, in consultation with the Secretary of the Treasury, would be allowed to sanction a foreign financial firm doing business in the U.S. if the foreign firm's home country does not provide effective national treatment to U.S. banks and securities firms -- i.e., the same competitive opportunities. Before sanctions are imposed, the Secretary of Treasury is required to identify which countries are not providing national treatment to U.S. financial firms; determine whether the denial is causing significant impact to U.S. firms; and begin negotiations with the offending countries.

With regard to foreign trade, it is my belief that big fences do not make good neighbors. One of the lessons of the 1930's was that trade barriers lengthened and deepened the Great Depression. By reverse logic, in recessionary times, promoting policies which impel the growth of international trade is likely to serve as an economic stimulant. That is why I am a strong proponent of NAFTA and the Uruguay Round on the General Agreement on Tariffs and Trade.

In proposing this legislation, it is not the intent to impose trade barriers in the U.S. financial services market. Instead, it is to add another arrow to the quiver of our trade negotiators in bilateral and multilateral efforts to effectuate the principle of equal treatment for U.S. financial firms, thereby lowering trade barriers throughout the financial services world.

Mr. Chairman, in closing, I look forward to hearing the testimony from today's witnesses and working with you and the others on the subcommittee in passing this legislation.

CAROLYN B. MALONEY
14TH DISTRICT, NEW YORK

COMMITTEE ON BANKING, FINANCE AND URBAN AFFAIRS

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Carolyn B. Maloney 2-1-94

OPENING STATEMENT

Subcommittee on Financial Institutions

Hearing on HR 3248, the Fair Trade in Financial Services Act
February 1, 1994

Thank you Mr. Chairman. I am very pleased that you scheduled this important hearing in advance of the House deliberations on US approval of the General Agreement on Tariffs and Trade.

Quite frankly, I was surprised to learn that the Secretary of the Treasury was lacking the authority to take action against the banking firms from countries that discriminate against American financial firms in their home markets.

While the European Union and the NAFTA nations are excluded from the provisions of this legislation, there are a number of other nations which enjoy the fruits of American financial markets without extending the same rights to US banking and financial firms.

I am heartened that the Office of the US Trade Representative has indicated that it views this legislation as "useful" to American efforts to conclude an equitable financial services accord as part of the overall GATT agreement.

Again, my thanks to Chairman Neal for scheduling this hearing in a timely manner that allows us to digest this information prior to making our final decisions of approval of the Uruguay Round of GATT.

STATEMENT OF THE HONORABLE LAWRENCE H. SUMMERS
UNDER SECRETARY FOR INTERNATIONAL AFFAIRS
U.S. TREASURY DEPARTMENT
BEFORE THE
SUBCOMMITTEE ON FINANCIAL INSTITUTIONS SUPERVISION,
REGULATION AND DEPOSIT INSURANCE
COMMITTEE ON BANKING, FINANCE AND URBAN AFFAIRS
U.S. HOUSE OF REPRESENTATIVES
TUESDAY, FEBRUARY 1, 1994

Fair Trade in Financial Services

I am pleased to have this opportunity to testify on the Fair Trade in Financial Services Act (H.R. 3248). As Secretary Bentsen and Ambassador Kantor stated in their recent letter, the Administration supports the objectives of this legislation and believes that prompt passage is an essential component of our strategy to continue multilateral negotiations to open foreign financial markets to U.S. financial institutions. We look forward to working with this Subcommittee and others in Congress to iron out any outstanding issues so that legislation can reach the President for signature soon.

The Uruguay Round Agreement on Trade in Financial Services

The recent conclusion of the Uruguay Round negotiations and bilateral discussions on financial services with a number of countries, particularly Japan, reaffirm our view of the need for and importance of this legislation. In Geneva we did well in reducing barriers to trade in the goods sector but we have an unfinished agenda in financial services.

Our objective in financial services has been, and remains, to obtain substantial market access and national treatment for U.S. banks, securities firms, insurance companies and other financial institutions. These firms are among our most competitive and are at the leading edge of the global financial market. Given an opportunity to compete, they will succeed.

In the Round, we obtained meaningful commitments from a wide range of countries, especially many of the industrial countries which today account for the bulk of the market. However, we are also looking to the future of the newly emerging markets where potential competitive opportunities are growing rapidly. Unfortunately, we were not able to obtain commitments to market access and national treatment in a number of key markets sufficient to warrant accepting an MFN-based agreement that would have provided these countries the same access to our open market that we were prepared to extend to countries with open markets.

The agreement on financial services adopted in Geneva will permit us to continue to negotiate until six months after the Uruguay Round Agreement enters into force. We are currently committed to preserve the existing operations and activities of foreign financial firms. However, we are not committed to granting new powers, expanded operations in new areas, or new entry.

At the end of the six month period following entry into force of the Uruguay Round, the U.S. will be free to submit any MFN exemptions we wish to take and to modify and finalize our market access and national treatment obligations.

This outcome has some virtues and provides opportunities. Let me explain.

- o First, we preserved our negotiating leverage. We retained our ability to use national treatment reciprocity as an inducement to open foreign financial markets.

- o Second, we can "harvest" any commitments we are able to obtain through these subsequent negotiations in the form of legally binding commitments in the General Agreements on Trade in Services (GATS).

- o Third, we have the prospect of broad multilateral framework for future liberalization in this area.

Where Do We Go From Here?

We intend to use the existing window to negotiate intensively to achieve further liberalization. Our goal will be to open foreign markets, not close the U.S. markets.

We will approach these negotiations in a reasonable and pragmatic manner. We believe that foreign financial firms can make important contributions to the development process. They bring additional capital, together with financial and managerial expertise. At the same time, we recognize that host countries have legitimate concerns. These include preserving a strong indigenous financial base, avoidance of overbanking in relatively small markets, and avoidance of market disruption. In addition, emerging market countries share the need that we all have to ensure the safety and soundness of their financial systems.

Liberalization is a process. It doesn't happen with the flip of a switch, but may take time. Therefore, we are prepared to consider transitional arrangements that provide breathing room for domestic firms to let them adjust to greater competition. What we have said is that we are willing to work with those countries which are willing to liberalize.

This leads us to the following basic guidelines for our financial services negotiations:

- First, in seeking market liberalization, we are looking for agreements which provide reasonable access to foreign markets and national treatment. We are prepared to guarantee full market access and full national treatment to countries that give our firms satisfactory access and national treatment.

- Second, we will take a constructive approach which, as we negotiate, keeps our markets open by grandfathering the existing operations of firms already established in our markets.

- Third, our objective remains an agreement that opens markets on a multilateral basis. However, we cannot accept a situation in which other nations retain the right to discriminate against our firms, while their firms are permitted to expand in our market.

The Importance of Succeeding

The stakes are high in terms of the economic and financial benefits we stand to gain. Our continuing effort to open foreign financial markets to fair competition for our financial institutions will have direct benefit for a sector which now accounts for over 6 percent of our GDP. U.S. financial institutions need to be able to compete in the markets of their major competitors if they are to remain competitive at home. Even now, roughly 10 percent of the total assets of U.S. banks are accounted for by their foreign affiliates.

Let me also emphasize that opening foreign financial markets serves the broader Administration goal of strengthening the economy. As President Clinton indicated a year ago, we must "compete not retreat." I cannot stress strongly enough how important this international competition is to our economic prosperity. But, we must have market access on fair terms to compete.

Open financial markets will also contribute to development that will mean better markets for all U.S. goods and services. Efficient and open financial services industries help integrate domestic and regional economies with the global economy. In Bangkok recently, Secretary Bentsen used the metaphor of the nervous system to emphasize the mutual importance and benefit of competitive financial services industries. "The sector," he said, "sends signals to the industrial muscle as to where those resources ought to go, where they'll have the most effective growth, the highest return." We strongly believe that greater market access in financial services is absolutely critical to creating economic growth for all nations. This will mean jobs for Americans.

We need the tools to make the competition in financial services fair. Our financial services firms are world class innovators and are prepared for the competitive international market place. For example, in 1992 we had more than 730 U.S. bank branches abroad with total assets of $300 billion. Fair Trade in Financial Services legislation would give us the negotiating leverage we need to overcome vested interests and open more markets abroad.

Discussion of Fair Trade in Financial Services

Based on our experience in the Uruguay Round, we continue to believe that the approach provided in Fair Trade in Financial Services legislation is necessary. Our experience has taught us the importance of negotiating within the financial services sector. This legislation is tailor made to strengthen our negotiating position.

We need an incentives mechanism. In an investment regime as open as ours, firms from the least open countries enjoy the same benefits as firms from the most open. Their home countries do not necessarily perceive a need to open to our firms. The asymmetry works against us in the negotiating context. Fair Trade in Financial Services legislation could help to redress the imbalance by allowing us to withhold future expansion and benefits from their financial firms.

Our approach to Fair Trade in Financial Services legislation reflects several key principles.

- First, the Secretary of the Treasury, in full consultation with the U.S. Trade Representative, the Secretary of State, and other relevant government agencies, should exercise authority to impose sanctions in accordance with the specific direction of the President, if any.

  Application of the discretion in this bill could have wide-ranging implications for U.S. finance. The Secretary of the Treasury, under the direction of the President and in consultation with other Executive Branch and regulatory agencies, is in the best position to make such decisions.

- Second, the legislation must be exercised in a manner consistent with and supportive of the commitments we ultimately may take in the GATS.

- Third, existing operations of foreign financial institutions already established in the United States should be protected. The impact of this legislation should be prospective in order to minimize the potential disruption to our market and possible retaliation.

  We do not want to jeopardize the economic and financial benefits of our open financial markets where, for example, more than 700 foreign bank offices account for over one fifth ($850 billion) of the total assets of our banking system and 35 percent of business loans. An estimated 300,000 direct and indirect jobs have been attributed to foreign banks alone; in addition, to which there are approximately 130 foreign-controlled registered broker-dealers and roughly 200 registered foreign investment advisers in the United States.

- Fourth, the regulatory authorities must be assured appropriate scope to exercise their statutory responsibilities to safeguard the safety and soundness and protect investors in the financial services sector.

- Fifth, the bill must provide ample discretion for negotiators, rather than automatic triggers tied to rigid deadlines.

Conclusion

The Administration appreciates the efforts by the sponsors and supporters of H.R. 3248 to provide the tools to enable us to obtain the substantial market access and national treatment for U.S. firms in foreign markets that other countries enjoy in our open market. We believe that H.R. 3248 goes a long way toward providing a more effective means of achieving this goal. Our negotiating effort is beginning a new phase and it is important that we implement this type of legislation now. We will work with you to achieve a bill that can be signed as soon as possible.

TESTIMONY OF AMBASSADOR RUFUS YERXA
BEFORE THE HOUSE BANKING SUBCOMMITTEE ON
FINANCIAL INSTITUTIONS
ON
FEBRUARY 1, 1994

Thank you, Mr. Chairman, for the opportunity to appear before your subcommittee and comment on the proposed Fair Trade in Financial Services Act. The Office of the U.S. Trade Representative is committed to expanding market access for, and improving treatment of, our very competitive banking and securities firms in foreign countries because of the close relationship between trade, investment and finance. Because the aim of the Fair Trade in Financial Services Act is the same, we support the legislation.

The Administration has stated that our trade policy must be part of a coordinated and integrated economic strategy, and the policy must be oriented toward expanding trade through market opening measures backed by the rigorous enforcement of U.S. laws. The Administration has also made it clear that we expect our trading partners to share responsibility for maintaining and expanding the global trading system to a degree commensurate with their new economic strength. This legislation will be useful within our overall strategy to expand trade.

This Act complements our success in financial services in the North American Free Trade Agreement (the NAFTA), and will supplement our efforts in the Uruguay Round of Multilateral Trade Negotiations in the GATT and the Japan Framework. We intend to

do all we can to ensure that U.S. banks and securities firms can continue to be innovative and competitive worldwide.

URUGUAY ROUND

We achieved an excellent overall result in the agreement on services (GATS) in the Uruguay Round negotiations. However, the results in terms of market access commitments in some sectors, notably financial services, were modest. We agreed on a framework for trade in financial services but did not obtain the full commitments on market access that we sought from a "critical mass" of countries, and have gained additional time to negotiate with our trading partners. However, the agreement provides for continuing negotiations within the GATT context to seek improved commitments. In the event that we are not able to achieve sufficient progress in these negotiations, this legislation will help ensure that we will have incentives to encourage other countries to liberalize in the future.

JAPAN

We are nearing the deadlines set last July when President Clinton and then-Prime Minister Miyazawa signed a Framework for consultations with Japan that calls for agreement on market-opening measures in several areas, including financial services. Negotiations are now actively under way.

The Japanese financial services markets are in most cases the second-largest, and in some cases the largest in the world. Effective access to these markets is very important for the ability of U.S. financial services firms to expand and remain competitive world-wide. Also, increasing U.S. financial services firms' access to Japan will help expand market access for other U.S. services and manufacturing companies. For this reason, we place great importance on the Framework financial services consultations.

The Fair Trade in Financial Services Act supports our efforts under the Framework. As the second-largest economy in the world, Japan must be aware that if it is not willing to provide greater openness and transparency for U.S. firms, Japanese companies will not be able to count on full and open access in the U.S. financial services market.

EFFECTIVE LEGISLATION

We support the legislation's intent to address market access problems in the highly regulated sectors of banking and securities. An effective policy instrument to achieve our goals should: 1) provide for the authority to act within the Executive Branch; 2) establish a well-coordinated interagency consultation process; 3) protect the interest of U.S. firms abroad; 4) support international legal principles; 5) utilize relevant dispute

settlement mechanisms in the GATT successor organization, the World Trade Organization (WTO); and 6) respect the authority of independent regulators.

Let me elaborate on two or three of these points.

1) Executive Authority and Consultations

Denying a foreign firm's opportunity to expand into new business in response to its home country's failure to provide for fair competition to U.S. banking and securities firms is a decision that should be made by the Executive Branch. Specifically, we believe that this responsibility for banking and securities should be lodged with the Secretary of the Treasury, in consultation with the Secretary of State and the U.S. Trade Representative; and should be subject to the specific direction, if any, of the President.

The process must allow for the exercise of discretion, not mandate action. This will ensure that the Executive can maximize the use of this new authority in conjunction with other policy instruments and guarantees that an appropriate range of U.S. interests are taken into account.

2) Protects U.S. Firms Abroad

We should be mindful of the affect this legislation would have on U.S. financial services firms established abroad. When the European Community passed the Second Banking Directive, the United States was assured that the Directive would not negatively affect U.S. banks already doing business in the EC that are subject to the Directive. The United States does not intend to target under this legislation existing operations of foreign companies established with in the United States. We believe that any policy should be focused on limiting access to new firms or new opportunities.

3) International Legal Principles and Relevant WTO Dispute Settlement Procedures

The United States has spent a great deal of time establishing an international investment regime grounded in sound legal principles. Any mechanism we establish through this legislation should respect these legal principles. We want to encourage countries to take advantage of the opportunity presented by continued negotiations under the GATS to open their financial services sector. Any country that guarantees national treatment and substantially full market access in its GATS commitments should be confident that it will not be disadvantaged under this legislation. The legislation should encourage such

participation, not discourage it.

CONCLUSION

As the examples given above show, the Administration intends to use every opportunity available, bilaterally or multilaterally, to ensure that U.S. banks and securities firms can continue to be innovative and competitive worldwide. At the same time, however, the open market of the United States is not "free" and we expect "fair" treatment of our banking and securities firms overseas.

The aim of this legislation is to provide an effective response, or should I say an incentive, if our trading partners fail to guarantee that U.S. financial services providers will be treated fairly. We believe it possible to develop mutually satisfactory language which will enable us to secure market access and better treatment for our financial service providers abroad. We look forward to working with your subcommittee.

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Statement by

John P. LaWare

Member, Board of Governors of the Federal Reserve System

before the

Subcommittee on Financial Institutions, Supervision,
Regulation, and Deposit Insurance
of the Committee on Banking, Finance and Urban Affairs

U. S. House of Representatives

February 1, 1994

I appreciate the opportunity to present the views of the Federal Reserve Board on the proposed legislation on Fair Trade in Financial Services (H.R. 3248). Given our role, as the central bank, in ensuring a healthy and efficient environment for the provision of financial services, the Federal Reserve has a special interest in this legislation.

On a number of previous occasions, before other committees, I have presented the views of the Federal Reserve on various proposals for legislation on Fair Trade in Financial Services. I will, therefore, keep my testimony brief and confine myself to those key points we consider to be of critical importance.

As I have emphasized before, the Federal Reserve shares the objectives of the proposed legislation. These objectives are important and their achievement desirable. U.S. financial firms deserve to have the same opportunities to conduct operations in foreign financial markets as domestic firms have in those markets. They do not now have those opportunities in all markets. According U.S. firms such treatment would benefit not only them, but also the host foreign countries themselves and the world financial system in general.

However, while sharing these important objectives, the Federal Reserve continues to oppose this kind of legislation. We oppose it for essentially two reasons. First, the existing U.S. policy of national treatment has served our country well. The

U.S. banking market, and U.S. financial markets more generally, are the most efficient, most innovative, and most sophisticated in the world. Consumers of financial services in the United States are provided with access to a deep, varied, competitive, and efficient banking market in which they can satisfy their financial needs on the best possible terms. Foreign banks, by their presence in the United States and with the resources they bring from their parents, make a significant contribution to our market and to our economic growth; they enhance the availability and reduce the cost of financial services to U.S. firms and individuals, as well as to U.S. public sector entities.

For these reasons, we simply do not consider legislation like that proposed to be in our own self-interest. If we were to adopt such legislation, we must be prepared to forego the considerable benefits of foreign banks' participation in our market if U.S. banks are not allowed to compete fully and equitably abroad.

Second, I note that the multilateral negotiations on trade in financial services will continue over the next two years, as agreed in the just concluded Uruguay Round. We believe that these negotiations offer the best hope for achieving further progress in the opening of foreign financial markets for U.S. financial firms and we strongly support the Treasury in its efforts in those negotiations.

We believe that the upcoming negotiations are at a critical juncture. It is incumbent upon the United States to

continue to provide leadership by example in this area for the rest of the world in order to preserve the principle of free, rather than reciprocal, trade. The former must continue to be our ultimate goal. Therefore, we do not agree with those who assert that the proposed Fair Trade in Financial Services legislation is desirable or necessary in the context of these negotiations. Indeed, it is our view, based upon experience, that market forces and the desire of foreign officials to enhance the functioning of domestic financial markets are often the most potent forces to induce financial market liberalization; the negotiations provide a valuable framework for guiding that liberalization.

That said, however, if other views prevail on the need for Fair Trade in Financial Services legislation, we would prefer the current proposal (H.R. 3248) over other proposals because it clarifies the possible sanctions authority and procedures in a number of important respects.

First, we believe that, as between financial and trade policy officials, it is more appropriate that the Secretary of the Treasury should have authority to make determinations regarding whether denial of national treatment to U.S. banking organizations by a foreign country has a significant adverse effect on such organizations, as well as recommendations regarding sanctions in appropriate cases. The Treasury Department is better positioned to make such determinations, in

view of the information available to the Treasury regarding the needs of both providers and consumers of financial services.

Second, the requirement that the Secretary consult with other relevant officials, including appropriate banking officials, before making such determinations helps to ensure that broader perspectives are incorporated in the decision-making process.

Third, the proposed legislation recognizes, in the residual discretion granted to the banking agencies, that imposition of sanctions in some circumstances, even if otherwise warranted, might be inconsistent with other objectives, such as the safe and sound operation of the financial system or the least-cost resolution of a failed bank.

Fourth, the proposed legislation excepts from its procedures countries that have provided the United States a binding and substantially full market access and national treatment commitment in financial services. This language seems to make clear that the legislation is intended to be an adjunct to the ongoing negotiations with countries that have not yet made such commitments and is not a rejection of the principles of free trade and national treatment.

Finally, we believe that it is appropriate and important that no provision is included for retaliation across financial services sectors. As a consequence, even if, for example, U.S. securities or mutual funds might be having problems

in other countries, U.S. banks and banking markets should not be jeopardized.

CONCLUSION

The desirability of market liberalization as an objective in the financial sector, as in other sectors, is virtually universally accepted. The United States has the opportunity to continue to exercise leadership in this area. I sincerely hope we take that opportunity. If not, any Fair Trade in Financial Services legislation should include the important improvements noted above in the current proposal. I would also like to echo the hope, recently expressed in a joint statement by the Bankers' Association for Foreign Trade, the Bankers Roundtable, and the American Bankers Association that the retaliatory mechanism of any Fair Trade in Financial Services Act will never have to be used.

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